PLAN SPONSOR
outlook
A Current Issues Resource for Plan Sponsors and Administrators
First Quarter 2013

Participant Deferral Rate Rose Slightly

How Does Your Plan Compare?

The average participation rate in 401(k) plans was 85.9% at the end of 2011, according to the *55th Annual Survey of Profit Sharing and 401(k) Plans* by the Plan Sponsor Council of America (PSCA). (The rate is defined as the average percentage of eligible employees who had a balance in their plan.) The rate the year before was 86.3%. An average of 80% of eligible employees made contributions to the plan in 2011.

The average participant pre-tax deferral rate was 6.4%, compared to 6.2% the year before.

Fast eligibility continued

About 60% of companies permit employees to contribute to their plan immediately. Almost half (46%) grant immediate eligibility to receive the company match, while 28% require one year of service.

Auto enrollment remained popular

- Nearly 46% of plans had an automatic enrollment feature.
- The most common default deferral rate was 3% of pay (54% of plans). More than 32% of plans reported a default deferral rate greater than 3%.
- Target retirement date funds remained the most common default investment option (70% of plans).
- About 55% of plans with automatic enrollment also provided automatic increases in contribution rates over time.

Need to fix a plan mistake?

The Internal Revenue Service has a section on its website devoted to common errors in qualified plans. *"Fixing Common Plan Mistakes"* describes common mistakes, and features links to correction procedures and advice on preventing future problems. For assistance, go to http://tinyurl.com/IRSFixingMistakes.

Roth feature usage rose

About 49% of plans permitted Roth 401(k) contributions, up from 45% the previous year. Of those eligible to make Roth contributions, 17% did so. Based on ADP test results, the average Roth deferral rate of lower-paid participants was 3.7%. For higher-paid participants, the average was 4.9%.

Other survey results included:

- The typical plan had about 61% of assets invested in equities.
- Immediate vesting of matching contributions was reported by 39% of plans.
- More than 15% of plans offered company stock as an investment option.
- Almost 91% of plans allowed hardship withdrawals, and about 2% of participants had such a distribution in 2011.
- Loans were permitted in 89% of plans. More than half of these plans (54%) allow only one loan at a time.
- About 68% of plans retained an independent investment advisor to provide guidance on fiduciary responsibility.

The survey reflects the 2011 experience of 10.3 million participants in 840 plans that had a total of more than $753 billion in plan assets.

The survey may be ordered from the PSCA at www.psca.org.

Investment Menu: Best Practices

Due to regulatory changes, market instability and large numbers of investment options, plan sponsors have been devoting more attention to their plans' investment menus.

A recent commentary from Vanguard identifies five best practices to assist plan sponsors in evaluating their menus while effectively communicating their plans to participants. To develop a sensible investment option menu and the necessary ongoing oversight, Vanguard suggests the following:

1. **Focus on the fundamentals of asset allocation, diversification and low costs.** These are proven strategies for long-term investment success and should be the foundation of an effective investment menu. Diversification neither assures a profit nor guarantees against loss in a declining market.

2. **Offer professionally managed solutions such as target date funds and managed accounts.** Target date funds, traditional balanced funds and managed accounts have helped participants construct well-diversified portfolios. They allow participants to take advantage of the principles of asset allocation, diversification and low costs in a single investment choice.

3. **Make available a core set of broad-market index funds.** Broad-market index funds cover the major asset classes, and have the potential to enhance retirement savers' wealth accumulation as a result of four characteristics: limited portfolio turnover, visibility of portfolio content and performance through benchmarks, diversification, and low management expenses and day-to-day costs.

4. **Make the investment menu more participant-focused.** One way to make the lineup more participant-friendly is to prevent choice overload. While the average number of options has risen in recent years, participants continue to invest in an average of only three. Offering more choices won't likely result in better decision-making or asset allocation by participants.

Another is to use a tiered menu, in which the investment options are presented within logical groups, such as active equity or international, as opposed to simply a long list arranged alphabetically.

5. **Pursue active, continuous oversight.** Due diligence includes setting clear objectives for the plan's investment menu, and documenting the investment choice selection and evaluation criteria. Overall, of course, there should be a detailed investment policy statement, which is reviewed on a regular basis.

Vanguard's commentary, "Constructing a defined contribution investment lineup: Vanguard's five best practices," is at http://tinyurl.com/InvestmentMenuBestPractices.

Pension Plan Limitations for 2013	
401(k) Maximum Participant Deferral	$17,500* *(*$23,000 for those age 50 or over, if plan permits)*
Defined Contribution Maximum Annual Addition	$51,000
Highly Compensated Employee Threshold	$115,000
Annual Compensation Limit	$255,000

Raise the Default Deferral Rate?

As demonstrated in previous research, automatic enrollment in 401(k) plans can have a large effect on retirement income adequacy. The impact of automatic contribution rate increases coupled with automatic enrollment has been less clear. New research from the Employee Benefit Research Institute (EBRI) seeks to fill that void.

The study analyzed the likely increase in "successful" retirements for participants in plans with automatic enrollment and automatic deferral rate increase features if all such plans set their default deferral rate at 6% of pay (as opposed to 3%, the most common rate). The results indicated significant increases in success rates for both low-income and high-income employees, assuming no change in opt-out behavior.

A "successful" retirement was defined as a 401(k) account balance large enough, when combined with Social Security benefits, to provide a real income replacement rate of 80%.

Researchers looked at employees in the lowest-income quartile in EBRI's Retirement Security Projection Model. They found that when actual default contribution rates were considered, only 62% would have a successful retirement. But, if plans adopted a 6% default rate, the percentage of successful retirements rose to nearly 72%.

When highest-income quartile employees were studied, the success rate was 41%. With a 6% default deferral rate, successful retirements rose to 52%.

EBRI's report, *"Increasing Default Deferral Rates in Automatic Enrollment 401(k) Plans: The Impact on Retirement Savings Success in Plans with Automatic Escalation,"* is at http://tinyurl.com/EBRIAutoEscalation.

To learn about plan requirements so that sponsors can implement practices, procedures and internal controls to monitor plan operations, see the Internal Revenue Service's "A Guide to Common Qualified Plan Requirements" at http://tinyurl.com/IRSQualifiedPlan.

Q&A

Plan Sponsors Ask…

Q: Are there any surveys describing participant reactions to the initial fee disclosure notices distributed last year?

A: The Plan Sponsor Council of America (PSCA) surveyed plan sponsors last October to determine if the fee disclosures had an effect on participants' behavior.

An average of 1.4% of participants presented questions about the notices they received, according to responding plan sponsors.

Almost 96% of plan sponsors indicated that they observed no change in the behavior of participants resulting from the disclosures. The most common change in behavior, reported by 2.3% of plan sponsors, was an increase in the number of requests from participants to change their asset allocations.

A little over 15% of plans reported that they issued a Request for Proposal or Request for Information as a step in complying with the fee disclosure rules.

See the PSCA's Snapshot Survey at http://tinyurl.com/PSCAFeeSnapshot.

Q: Since the Internal Revenue Service discontinued its letter-forwarding program to help find lost participants last year, what other steps can we take?

A: The Department of Labor (DOL) suggests these methods in attempting to locate missing participants who may be due benefits:

- Use certified mail
- Check related plan records, such as a group health plan
- Contact the designated plan beneficiary
- Use a letter-forwarding service, such as the one offered by the Social Security Administration

Note that the DOL's *Field Assistance Bulletin 2004-02* covers, in addition to these steps, other very helpful information about plan sponsors' fiduciary duties with respect to missing participants. The Bulletin is at http://tinyurl.com/DOLFAB2004-2.

You may use the Social Security Administration (SSA) letter forwarding service—there is a charge of $25 per letter. Be aware that the SSA usually forwards the sponsor's letter to the employer who most recently reported earnings for the missing participant. The current home address is used if the person is receiving Social Security benefits.

The SSA's program description is at http://tinyurl.com/SSALetter.

Q: We're considering putting a QDIA in our 401(k) plan. What qualifies as a QDIA?

A: A qualified default investment alternative (QDIA) is a default investment fund that receives participants' plan contributions when the participant fails to make an investment election. Introduced in the Pension Protection Act of 2006, the Department of Labor issued regulations specifying how a default fund may be qualified and therefore reduce fiduciary liability for plan sponsors.

The Department of Labor indicated that an approved QDIA is:

- A product with a mix of investments that consider the individual's age or retirement date, such as a lifecycle or target date fund
- An asset mix that takes into account the participant's age or retirement date, such as professionally managed account
- An investment mix that considers the characteristics of the employee group as a whole, such as a balanced fund
- A stable value fund, but only for the first 120 days of participation

Safe harbor relief and other key aspects are discussed in a helpful QDIA fact sheet, which is at http://tinyurl.com/QDIABasics.

The National Retirement Risk Index

The Center for Retirement Research at Boston College has calculated the National Retirement Risk Index (NRRI) for a number of years. It compares projected income replacement rates with target rates that would permit workers to maintain their pre-retirement living standard and estimates the percentage at risk of not meeting target replacement rates.

The NRRI rose to an average of 53% for all income groups in the latest study. Nearly two thirds of workers in the low income group were at risk. More than half of the middle income workers and nearly half of high income workers were at risk, as well.

The authors of this study concluded that more than half of households will not have sufficient income in retirement to maintain their pre-retirement standard of living, even if they work to age 65 and annuitize all of their financial assets. As a result, focusing on increasing retirement savings is even more crucial for plan sponsors and participants.

The full report, "The National Retirement Risk Index: An Update," is at http://tinyurl.com/NRRIUpdate.

Web Resources for Plan Sponsors

Organization	Website
Internal Revenue Service, Employee Plans	irs.gov/ep
Department of Labor, Employee Benefits Security Administration	dol.gov/ebsa
401(k) Help Center	401khelpcenter.com
Plan Sponsor Magazine	plansponsor.com
BenefitsLink	benefitslink.com
Profit Sharing/401(k) Council of America	psca.org
Employee Benefits Institute of America, Inc.	ebia.com
Employee Benefit Research Institute	ebri.org

Plan Sponsor's Quarterly Calendar

April

- If a plan audit is required in connection with the Form 5500, make arrangements with an independent accountant/auditor for the audit to be completed before the Form 5500 due date. (Calendar year plans)
- Audit first quarter payroll and plan deposit dates to ensure compliance with the Department of Labor's rules regarding timely deposit of participant contributions and loan repayments.
- Verify that employees who became eligible for the plan between January 1 and March 31 received and returned an enrollment form. Follow up for forms that were not returned.

May

- Monitor the status of the completion of Form 5500, and, if required, a plan audit. (Calendar year plans)
- Issue a reminder memo or email to all employees to encourage them to review and update, if necessary, their beneficiary designations for all benefit plans by which they are covered.
- Perform a thorough annual review of the plan's Summary Plan Description (SPD) and other enrollment and plan materials to verify that all information is accurate and current, and identify cases in which revisions are necessary.

June

- Begin planning an internal audit of participant loans granted during the first six months of the year. Check for delinquent payments and verify that repayment terms and amounts borrowed do not violate legal limits.
- Confirm that Form 5500, and plan audit if required, will be completed prior to the filing deadline or that an extension of time to file will be necessary. (Calendar year plans)
- Review plan operations to determine if any qualification failures or operational violations occurred during the first half of the calendar year. If a failure or violation is found, consider using an Internal Revenue Service or Department of Labor self-correction program to resolve it.

Consult your plan's financial, legal or tax advisor regarding these and other items that may apply to your plan.

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